Caribbean debt and the Jamaica Debt Exchange: A pause for thought

Michele Robinson
Debt Management Consultant

December 2, 2010
Outline

- Debt situation in the Caribbean
- Options for debt reduction
- The Jamaica Debt Exchange
Current Situation – Public Debt-to-GDP (end 2009)

- St. Kitts & Nevis: 184.7
- Jamaica: 134.0
- Grenada: 122.3
- Antigua & Barbuda: 118.3
- Barbados: 104.9
- Dominica: 83.8
- Belize: 80.2
- St. Vincent & the Grenadines: 75.0
- St. Lucia: 74.7
- Guyana: 60.5
- Bahamas: 41.4
- Trinidad & Tobago: 32.4
- Suriname: 20.3

Source: IMF
Most Caribbean economies are environmentally vulnerable due to climate change, natural disaster, which has a negative impact on fiscal accounts and growth.

Extremely vulnerable:
- Barbados
- Grenada
- Jamaica
- St. Lucia

Highly vulnerable:
- St. Kitts and Nevis
- St. Vincent & the Grenadines

Vulnerable:
- Antigua and Barbuda

At Risk:
- The Bahamas
- Belize

Resilient:

Source: United Nations Environment Programme (UNEP) and South Pacific Applied Geoscience Commission
Trends are worrying...

Comprehensive Debt Restructuring
- Between 2000-2004: Belize, Dominica, Guyana
- Between 2005-2008: Grenada, Guyana
- 2010: Antigua and Barbuda, Jamaica

Credit Ratings
- 2010: 3 countries downgraded by S&P (The Bahamas, Barbados, Jamaica)
- Main concerns fiscal challenges, increase in debt burden, contingent liabilities

Exceptional Financing
- 2010 Increasing number of countries sought IMF assistance (Antigua and Barbuda, Grenada, Jamaica)
- Many territories (Cayman, Turks and Caicos received approval to borrow)

Deficits and Debt
- Revenue flat or declining for 9 of 13 countries
- Deficits high and debt increasing rapidly
Growth is weak for the near future…
...and debt-to-GDP is forecast to rise in most Caribbean countries
Current debt situation in the Caribbean

Options for Debt Reduction

The Jamaica Debt Exchange
Options for debt reduction in the Caribbean

- Fiscal adjustment and reform
  - Cutting expenditures, strengthening tax administration
  - Enacting fiscal responsibility legislation
- Growth
  - Diversifying the economy, attracting foreign investment
  - Further expanding the tourism sector
- Improved debt management
  - Seeking more concessional financing
  - Developing and implementing a debt strategy
  - Implementing debt restructuring
- Call for a Caribbean debt initiative
  - Commonwealth Secretariat championing effort for SVEs
Current debt situation in the Caribbean

Options for Debt Reduction

The Jamaica Debt Exchange
The Jamaica Debt Exchange (JDX)
Jamaica Observer article – 07/11/2010

BUSINESS

JDX successful beyond expectations — World Bank

BY AL EDWARDS
Sunday, November 07, 2010

THE implementation of the Jamaica Debt Exchange (JDX) as a means of reducing interest payments on the country’s huge debt burden has proven successful beyond expectations said the World Bank Group’s Vice-President for Latin America and the Caribbean, Pamela Cox.

Speaking with Sunday Finance in an interview last month in Washington DC at the IMF/World Bank Annual Meetings, she said: "The JDX has been successful beyond our expectations. To have a buy-in of over 99 per cent is incredible. Most countries struggle to get the required 80 per cent. The JDX has almost halved the interest rate the government is paying. However, this is not the solution to everything. The government still needs to follow the strict macroeconomic policies. Just because we have the JDX doesn’t mean it is time to go have a party, that’s our message."
The Background
Jamaica’s economic growth well below potential and economy highly sensitive to external shocks.
Jamaica’s debt has been unsustainable...
...and domestic debt has surged.
The turning point in 2009

- Total public debt US$13.4 billion (135% of GDP) at end-2009
- More than half the debt owed to domestic creditors
- Total debt service costs exceed 100% of government revenues
- Interest payments exceeded 65% of government revenue
- Interest rates on many government securities over 20%
- Over 25% of government securities matured in 24 months

Domestic debt
- Owed mainly to merchant banks, commercial banks, insurance companies and pension funds (80%)

External debt
- Owed mainly to private bondholders and multilateral lenders
Programme Framework

Fiscal Reform

Economic Programme

$1.3 bn IMF Standby Agreement
$1.1 bn Multilateral Funding

Jamaica Debt Exchange (JDX)
Exchange Offer Strategy: Development

- Development of the GOJ first domestic exchange offer began November, 2008 with financial advisor (Citicorp)
- Initial transaction conception was a J$150 billion debt extension
  - Focus on debt maturing within 2 years to lower refinancing pressure on rates
- Broad market consultation carried out actively between March 2009 and January, 2010 (launch date)
- Scope of the exchange offer change due to increase in market rates
  - Shift from addressing the shortest bonds only to the entire portfolio
- Final consultations with financial advisors, the IMF, the IADB, and the World Bank carried out in November and December, 2009
  - Objective - assure full integration with the Government’s medium-term economic program
Exchange Offer Strategy: Market Consultation

- Market consultations extensive
  - Group meetings (April and August, 2009)
  - One-on-one meetings with leading banks, securities dealers, and pension managers
- Consultations included discussion of a local market initiative from February, 2009
- Key results of the consultations incorporated into the final proposal
- Final market pre-consultation January 10th – 13th, 2010 led to some further changes (e.g., addition of new 30 Year fixed rate bond)
The Jamaica Debt Exchange – The Transaction
Objectives of the Debt Exchange

- Improve maturity profile
- Achieve substantial cost savings
- Seek to increase fraction of fixed rate debt in the portfolio
- Ensure banking system stability
- Obtain substantially 100% participation rate
- Include a simple choice for small investors to allow for a high level of retail participation
- Bifurcate submission process to:
  - Allow mass processing of small retail orders
  - Efficient processing of a small number of very large and complex institutional orders

Source: Ministry of Finance
## Summary Term Sheet

<table>
<thead>
<tr>
<th>Expiration Date:</th>
<th>January 26, 2010 (Extended to February 3\textsuperscript{rd}, 2010)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Settlement Date:</td>
<td>February 16, 2010 (Extended to February 24\textsuperscript{th}, 2010)</td>
</tr>
</tbody>
</table>
| Eligible bonds:  | • About J$701 billion local law bonds (FR/VR/USD)  
|                 | • Marketable Bonds issued prior to December 31, 2009 and maturing after February 16, 2010  
|                 | • External law bonds excluded |
| Transaction Type:| • Par-for-par exchange offer  
|                 | • Accrued interest paid in cash |
| New Bonds:       | • 24 new benchmark bonds (and a 1-Year retail bond added)  
|                 | • Fixed Rate bonds are non-call life, Variable Bonds fixed up front for up to 12 months |
| Pricing:         | • New J$ bonds priced in the range of 12-13%  
|                 | • USD bonds priced near 7% |
| Allocation Rules:| • All exchanges will be from shorter dated bonds to longer dated bonds  
|                 | • Fixed Rate only to Fixed Rate  
|                 | • USD only to USD  
|                 | • Variable Rate to Variable Rate, Fixed Rate, or CPI-indexed |
| Target participation: | • Substantially 100%  
|                 | • Bonds maturing within two years and high coupon fixed rate bonds |

Source: Ministry of Finance
Results of Transaction
Results of Transaction

**Participation**

- Over 99% participation rate
- Nearly 100% participation within the institutional investor class
- Very high participation by retail investors

**Key Portfolio Results:**

- Annualized pre-tax cash flow cost savings of over J$42 billion.
- Maturity profile substantially extended and smoothed. **Over J$300 Billion reduction in principal maturities 2010 – 2012.**
- Fixed rate share of debt increased by 7%
- 350 small bonds replaced by 24 benchmark bonds
Results of Transaction: Maturity Profile Before and After

Portfolio: Before

[Graph showing maturity profile for Portfolio: Before with years 2010 to 2040 on the x-axis and values ranging from 0 to 180,000 on the y-axis. The graph includes bars for FR, VR, USD, and CPI with non-participants.]

Portfolio: After*

[Graph showing maturity profile for Portfolio: After with years 2010 to 2040 on the x-axis and values ranging from 0 to 180,000 on the y-axis. The graph includes bars for FR, VR, USD, CPI, and non-participants.]

Source: Ministry of Finance
**Results of Transaction: Portfolio Parameters**

<table>
<thead>
<tr>
<th></th>
<th>Before</th>
<th>After</th>
<th>Change</th>
</tr>
</thead>
<tbody>
<tr>
<td>Variable Rate</td>
<td>54%</td>
<td>44%</td>
<td>-10%</td>
</tr>
<tr>
<td>Fixed Rate</td>
<td>34%</td>
<td>41%</td>
<td>+7%</td>
</tr>
<tr>
<td>USD</td>
<td>12%</td>
<td>12%</td>
<td>Unchanged</td>
</tr>
<tr>
<td>CPI-Indexed</td>
<td>0%</td>
<td>3%</td>
<td>+3%</td>
</tr>
</tbody>
</table>

- The objective of increasing fixed rate debt and lowering variable rate debt was successfully achieved.

Source: Ministry of Finance
Success factors

- Broad national consensus
- Extensive market consultation
- Commitment to economic and structural reform
- Precondition to exceptional multilateral support
- Supporting Framework
- Simplification of the debt exchange for small retail investors
- Closure of the international capital markets
Issues Arising

- **Positives**
  - Lower debt service costs – less risk of default
  - Lower interest rates – spill-over effects on growth
  - Less draconian tax measures/fiscal adjustment
  - Implementation of fiscal responsibility framework

- **Negatives**
  - Lower bank profitability - higher bank charges
  - Reduced income for pensioners
  - Lower investment yields
Aim to reduce public debt/GDP to 100% or less by 2016

The momentum of the JDX must be followed by “an aggressive debt reduction strategy to reduce the public debt-to-GDP to sustainable levels over the medium to long term...”
And then there were none…

Thank you